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January 27, 2021

Mr. Tom Seidenstein and Ms. Bev Bahlmann
International Auditing and Assurance Standards Board
529 Fifth Avenue
New York, New York 10017

Dear Tom and Bev,

We are delighted to submit our report, *Fighting Fraud: Conversations with Leading European Audit Committee Chairs,* as a comment for the IAASB's current consultation on fraud and going concern in an audit of financial statements. The report describes the broad-ranging perspectives on fraud of audit chairs who are members of the European Audit Committee Leadership Network (EACLN). Answers to specific questions in the discussion paper appear in the appendix. We look forward to discussing the report with you in our upcoming EACLN meeting.

Sincerely,

Michael Mahoney

Michael Mahoney
Partner, Tapestry Networks

JANUARY 2021

Fighting fraud

Conversations with leading European audit committee chairs

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Fighting fraud: Conversations with leading European audit committee chairs

In late 2020, Tapestry Networks convened audit committee chairs from some of Europe's largest companies to discuss how the various stakeholders, including the external audit process can contribute to detecting and preventing corporate fraud. This report presents those audit chairs' perspectives based on their experiences with listed companies in Europe, as well as perspectives that Tapestry Networks has developed in reflecting on the situation and the audit chairs' comments. We believe that the report stands on its own; Tapestry is also submitting it in response to the International Auditing and Assurance Standards Board (IAASB) discussion paper *Fraud and Going Concern in an Audit of Financial Statements*. An appendix to this report provides responses to specific questions raised by the IAASB. These responses reflect Tapestry Networks' conclusions, rather than individual or collective statements of the audit chairs.

The audit chairs whom we interviewed serve on boards of listed European companies having at least US$10 billion/€8.2 billion in annual revenue and global operations. Such companies typically retain Big Four firms to conduct external audits and have sophisticated internal audit teams and robust internal-controls frameworks. Audit chairs of smaller or less complex companies may have different perspectives.

The following current and former audit chairs participated in interviews and meetings between November 2020 and January 2021:

- Carolyn Dittmeier, Chair, Board of Statutory Auditors, Assicurazioni Generali
- Eric Elzvik, Audit Committee Chair, Ericsson
- Byron Grote, Audit Committee Chair, Tesco, Akzo Nobel, and Anglo American
- Simon Henry, Audit Committee Chair, Rio Tinto
- Liz Hewitt, Audit Committee Chair, National Grid and Melrose
- Lou Hughes, former Audit Committee Chair, ABB
- Arne Karlsson, Audit Committee Chair, Mærsk
- John Rishton, Audit Committee Chair, Unilever
- Sarah Russell, Audit Committee Chair, Nordea Bank
- Guylaine Saucier, Audit Committee Chair, Wendel
- Alan Stewart, Audit Committee Chair, Diageo

The interviews and discussions were held under a modified form of the Chatham House Rule, which allows for quotation of any comment but not for its attribution to an individual or company. Audit chairs spoke on their own behalf rather than as representatives of their companies or boards. EY provided financial support for the research and writing of this report and had opportunities to comment on the research design and the final product but did not exercise any editorial control over this report, for which Tapestry Networks bears full responsibility.

Key observations about fraud

The audit chairs whom we interviewed agreed on the following:

- Stakeholders use the word "fraud" in many contexts. Fraud should be carefully defined in discussions among diverse stakeholders when considering whether any changes are necessary.
- Collusive fraud at high levels of management is extremely difficult to detect.
- Corporate culture and management's tone at the top are key factors that can create an environment that is conducive to fraudulent activity, as well as whether employees feel comfortable reporting such activity to management and the board.
- To prevent and detect fraud, audit committees and boards rely first on management, including compliance and internal audit. The external audit, leveraging capabilities such as data analytics, can provide meaningful insights to inform the board and audit committee's oversight. External auditors can supplement companies' fraud detection and prevention efforts with capabilities such as data analytics.
- While supportive of exploring ways to make auditors more effectively exercise professional skepticism, adopting a suspicious mindset in all cases may not be helpful.

The content in this report details the audit chairs' reactions to the IAASB discussion paper and the bases for their agreement on the observations listed above.

Tapestry's perspectives

Tapestry Networks, speaking on its behalf only, offers its perspectives based on its discussions with the participating audit chairs. We do not attribute these conclusions to the audit chairs we interviewed, individually or as a group:

- **Management teams, with the help of the internal audit function, could do more to prevent and detect fraud.** Line management and corporate functions such as compliance and risk management are, respectively, the first and second lines of defense against fraud, maintaining robust internal controls and nurturing a culture of compliance and whistleblowing. A strong and independent internal audit function is the third line, harnessing the risk management system and sophisticated analytics to assess how the first and second lines are performing.

- **Audit committees could do more in their oversight capacity to encourage the detection and prevention of fraud at their companies.** Audit committees review the internal control and whistleblowing systems, as well as the company culture, and they can study specific instances of fraud to glean lessons and demonstrate the importance of fraud prevention. Through training and attention to the experience and skills of committee members, they can better overcome the inherent imbalances in knowledge between non-executive directors and management.
- **Current audit standards seem to strike the right balance, but enhancements to recognize advancements in the use of data analytics would be appropriate.** External auditors are already doing most of what can feasibly be done to prevent and detect fraud. While improvement is always possible and standards should evolve – to recommend, for example, expanded use of data analytics and forensics – fundamental changes in approaches and procedures (such as adopting a "suspicious mindset") are not necessary today.

Preliminary observations about the fraud "expectations gap"

The high public profile of recent corporate-fraud incidents has led to renewed calls for auditors and the audit process to assume greater responsibility for detecting and preventing fraud, and even for auditors to bear stronger liability in the event of fraud. But audit firms and corporate leaders responsible for the audit processes in listed companies often have different views from the public about the current scope of an audit and its ability to combat fraud. The difference has come to be known as the "expectations gap." Recent proposals for audit reform have aimed at closing the gap.

The European audit chairs we interviewed noted several broad observations, outlined below, about the fraud expectations gap.

Fraud comes in many forms

European audit chairs emphasized that when evaluating whether any changes are needed relative to stakeholders' responsibilities for the prevention and detection of fraud, "fraud" should be appropriately defined to effectively assess any changes and their potential impact. One chair elaborated on the concern: *"We need to explain what we mean by fraud. As audit chairs, we are worried about high-level corporate fraud creating misstatements of financial statements. Other types of fraud, like bribery and corruption, might not be reflected in financial statements. You could do any amount of analysis and not find it."*

Several audit chairs observed that many stakeholders tend to conflate all "bad" corporate behavior—whether illegal, unethical, or merely reputationally harmful—with fraud. They said that such a broad definition can complicate the effort to close the expectations gap. One audit chair noted, *"Any company that doesn't meet investors' expectations needs to strengthen its audits. But that failure to meet investors' expectations could be the result of weak management, not fraud."* Another audit chair called for a focus on frauds that not only were formally material but also had catastrophic consequences for a company.

Highly consequential fraud is rare

Fraud of the severity that reaches stakeholders' attention occurs infrequently. While audit chairs acknowledged that material fraud may occur more often at smaller companies with fewer resources to assess and mitigate fraud risk, they wondered about balancing the potential costs and benefits that might results from any potential changes to stakeholders' responsibilities. One chair said, *"There are big media splashes when a major fraud occurs, but you don't see that every day from every company. You cannot have all companies pay for a tiny percentage of companies' fraud. We have to put things in perspective."* Another audit chair agreed, noting that companies typically succeed in preventing and detecting fraud: *"In most cases, material fraud is caught by the company. One or two high-profile instances of fraud do not mean that the system is broken and requires substantially enhanced procedures."* At the same time, audit chairs acknowledged that, even though severe cases of fraud are rare, they can have broad and lasting consequences, undermining confidence in capital markets and the broader economic system.

Collusive fraud is very difficult to prevent and detect

Many of the major fraud incidents that elicit public outcry are the result of collusion among executives. The European audit chairs emphasized that collusion can often bypass the internal controls meant to prevent fraud. One noted that these types of fraud are *"very difficult to root out."* Another agreed, noting that while *"major collusive fraud eventually gets uncovered, if people collude it means the independence has broken down, and it's hard to promptly determine that."* Another audit chair observed that *"no amount of review will identify all cases of fraud."* Given that preventing and detecting all instances of collusive fraud may be effectively impossible, the imposition of heightened standards alone may not address the underlying challenges. *"If there is collusion at the top level, doing all that we can still won't eliminate it. We have to be careful about widening the expectations gap about prevention and detection."* Management, audit committee and the external audit will need to continue to explore cost effective ways to assess and respond to fraud risks.

Perspectives on management's responsibilities

European audit chairs said that primary responsibility for fraud detection and prevention rests with management and internal audit teams. The European audit chairs were reluctant to increase the external auditor's fraud detection and prevention responsibilities.

Effective internal audit can be a critical resource

Audit chairs were confident in the ability of management, supported by robust, independent internal audit functions, to prevent and detect fraud and generally believed that they should continue filling that role. *"Preventing and detecting fraud is management's job through the first and second lines of defense. You need robust controls, a framework, and a strong tone from the top to manage this kind of risk. That's the major starting point."* An audit chair emphasized that *"solid information-technology general controls are one of the cornerstones of fraud prevention and detection."* These audit chairs serve on the boards of some of Europe's largest companies. Not all internal audit organizations will have the same level of sophistication and available resources as found in these companies.

Some audit chairs thought that the work of sophisticated internal audit departments is not sufficiently understood: *"There are many areas of fraud that are not as well-known as what gets publicized, but world-class internal audit departments know about them."* Internal audit departments work with robust enterprise risk management systems that help combat fraud risk; external auditors can review these systems to ensure that they are effective. An audit chair added that there is a *"behavioral aspect to fraud to which internal audit has particular insight."* Another audit chair observed that internal auditors are benefiting from *"an increased use of data analytics by both the second and third lines of defense as systems evolve."* The chair added, however, that *"data analytics is more effective in identifying small-scale breakdowns in internal controls than the type of mega fraud that has driven the current debate."*

Internal audit plays an important role in preventing and detecting fraud, but some audit chairs emphasized that internal prevention and detection of fraud begins and ends with executives. One said, *"We hold people accountable for fraudulent activity and noncompliance with policies, but it shouldn't be just the individual actors; it should be their superiors, because it happened on their watch and they weren't paying attention."* While the European audit chairs consulted for this report agreed that internal audit is a critical resource for fraud detection and prevention, the companies on whose boards they sit typically have large, sophisticated internal audit functions. Smaller companies may struggle to rely on their internal audit teams in this way.

There are strong parallels between compliance oversight and fraud detection and prevention

Several audit chairs noted that overseeing fraud prevention and detection is closely related to overseeing a company's compliance function, an important component of its second line of defense. Many audit chairs agreed that whistleblower programs are critical to detecting fraud. One explained, *"Companies need whistleblowing systems that are managed with independence and proficiency. The audit committee and external auditor should have transparency into specific cases, and internal audit should be involved. We've strengthened that role recently in part because whistleblowing is less common in certain geographic regions."* The same audit chair said that one company created an ombudsman role to independently handle whistleblower matters, which would encourage more reporting of potential fraud concerns.

Another audit chair emphasized that, more than facilitating a so-called speak-up mentality, companies should foster a *"speak-up obligation, meaning that you are in trouble if you do not speak up when you see something wrong or get a strong indication that unethical activity is taking place. You should have an obligation to raise hands and voices, and not be permitted to look the other way."*

Perspectives on the role of the board and the audit committee

European chairs agreed that boards and specifically their audit committees play an important role in fraud prevention and detection. An audit chair explained the tasks that audit committees should undertake: *"In the audit committees I'm on, we review the processes that are in place to prevent fraud, including the controls that are in place and the mechanisms whereby individuals who see something wrong can raise them through whistleblowing."* The audit chair noted that these tasks are standard for many audit committees: *"They are nothing new. Setting those tasks as requirements would be no problem for many audit committees."*

In addition to reviewing processes and controls, audit committees and boards can also study specific instances of fraud. An audit chair said that audit committees should assess any cases of fraud that have occurred and the specific actions the company is taking in response. Another noted that this approach can be instrumental in making whistleblower programs effective: *"The 'speak-out' program can report back to the board through the audit committee. It sends a powerful signal that the process works if reports to the board get follow-ups. The audit committee can have a huge influence on this."*

Again, internal audit is a key ally in these efforts, audit chairs said, and the audit committee should be sure that it is adequately staffed. As one audit chair explained, *"The audit committee should use internal audit to receive independent assurance about the adequacy of controls around prevention and detection. I think this is the most important area. We've hired two more internal audit forensics experts at our company to strengthen this function. That's where the main audit function should be when it comes to fraud."*

Audit committee oversight could be improved

European audit chairs acknowledged that there is room for improvement in how audit committees handle their responsibilities. *"At the end of the day, I think many audit committees need to up their game,"* one chair said. One approach is through board composition. An audit chair said, *"It's about putting together diverse boards. By definition, you then have people of different backgrounds and you end up with just a few sector specialists. What you're trying to do is look at the company from many angles. You're looking for some dimension to the board that isn't related to the sector but that, for other reasons, the board views as important."*

Training is also critical, particularly in certain areas. *"We probably should have more mandatory education for audit committee members on things like data analytics. We need to decide on a core curriculum and mandate a certain number of hours of education per year,"* one audit chair said. Another added, *"Audit committees would benefit from an awareness and training piece on forensics. One company requires non-executives to do antibribery, anticorruption, and cyber training."* Ultimately, audit committees also need to cultivate a certain mindset, an audit chair suggested: *"It's not a bad thing for the audit committee to have a questioning mind—it's a collective duty. We are non-executives and independent; we should have a good nose for where risk is and what questions to ask."*

However, audit chairs also noted that, even with enhanced training and effort, there are inherent difficulties in overseeing fraud prevention and detection. One issue is the need to have a good relationship with management. As one audit chair put it, *"A challenge for boards is the difficulty of having a discussion with the management team that you're supposed to trust. When the news is bad, you naturally dig deeper. But when the news is good, you may be tempted not to question it."*

Another issue stems from the inevitable disparity in knowledge between board members and executives. An audit chair explained, *"CEOs spend 24 hours per day on the job; they live and breathe it. Boards spend a couple of weeks per year on the company, and it's all stage-managed. You are in meetings planned by executives; visits are preplanned. The shadow of the leader is very powerful. Many executives are hesitant to contradict the CEO, their boss."* That imbalance means that one of the most important tasks of the board is selecting the right executives, the audit chair noted: *"The board relies heavily on the CEO. Getting that choice right is 90%. If you get it wrong, they can easily deceive you."*

Should there be attestation by the board or audit committee?

Attestation along the lines of the US Sarbanes-Oxley legislation, which requires extensive management certification of the internal-control system, already exists or is under consideration in European countries, but the discussion also includes the possibility of attestation by boards or audit committees as well as management. Audit chairs noted that attestation by management has added accountability, consistency, and focus in implementing and maintaining the controls framework.

They had mixed views, however, on requiring such attestation by the board or audit committee. One audit chair tentatively supported the idea: *"So long as it's phrased appropriately, I wouldn't have problems signing off for the audit committee. It does push liability exposure to board members further, so that would have to be thought through. At the end of the day, the attestation is that the controls are in place but not that they're fail-safe."* Other audit chairs were opposed to attestation by boards. *"If the board also has to sign off, you mix up the supervisory role and the operational role. You have to draw the line somewhere. The signing of the annual report should be sufficient,"* one audit chair noted.

Challenges in assessing corporate culture

Many audit chairs observed that corporate culture plays a central role in both fostering and discouraging fraudulent behavior. Culture can provide guide rails and cues for ethical behavior; it can strengthen the whistleblowing system by encouraging people to speak up if they believe something is wrong. But culture can also impose strong pressures on people to test the boundaries of ethical behavior. One audit chair noted, *"It boils down to the culture of the organization and its values, and how people are rewarded."* Despite its importance, however, culture is challenging for boards to assess and influence, and it may be even more challenging for both internal and external auditors to audit.

An audit chair mentioned the dilemma for boards, bringing up the difference in knowledge of the company enjoyed by executives versus non-executives: *"Boards should do more on culture, but it's very difficult. After six months as an executive at a company, I knew more about the culture than after two years as a non-executive at the same company."* The same audit chair elaborated on another challenge of assessing culture: *"The board most often interacts with senior executives. It can be challenging for board members to get a sense of the people lower down in the organization. And whenever people are talking to the board, they are on their best behavior."*

Nevertheless, boards should try to assess company culture, audit chairs said, and many boards are doing so. An audit chair recommended that boards *"spend more time acknowledging corporate culture, not just with a bullet about oversight and incentives, but by talking more about raising hands, voices, and whistleblowing. Understand the four-eyes principle [requiring two people to approve an action] and the separation of duties."* Companies often conduct company-wide surveys that include questions about culture, and the results are reviewed by boards. Vulnerabilities to fraud risk can be exposed, allowing the board to react.

An audit chair emphasized that the audit committee plays an important role in this oversight through its responsibility for ensuring that the whistleblowing system is functioning effectively and that an effective internal-control system is in place. Sometimes an audit committee or board may decide to follow up on a hunch: *"We have all been in meetings where we feel that something is wrong,"* one audit chair said. Another called for special attention to areas where senior managers may be exerting pressure on more junior staff, increasing the likelihood of fraud: *"profit pressure, bonus pressure, market-share pressure."* Other audit chairs agreed that aggressive bonus schemes and budgetary pressures have contributed to major frauds, and one highlighted the importance of understanding the connections between remuneration schemes and culture.

Assessments of corporate culture are critical to informing management, internal audit, the audit committee, and the external auditor in their assessments of fraud risk, but the subtler aspects of culture make it hard to audit in a more formal way, several audit chairs said. They mentioned assessing—both directly and indirectly—elements of culture such as comfort with escalating issues, confidence in working with others, and leadership. An additional complication emerges in companies that have a variety of subcultures, in which different types of activities lead to different norms and values. One audit chair suggested that it may be particularly difficult for the people who traditionally make good auditors to assess these kinds of variables: *"They struggle with it; they tend to be analytical as opposed to emotional."*

Given the internal audit function's role in fraud detection more generally, as well as its deep understanding of company processes, assessing culture should be a key consideration as part of its responsibilities, according to some audit chairs. *"The internal audit plan should include culture and behavior. It makes sense there,"* one audit chair noted. Another added, *"Internal audit can do it for you, with a line of sight directly to the board."* The goal is to *"create a bigger dialogue around things like culture and what prevents people from whistleblowing or acting* *earlier. There's not enough discussion about these soft issues. All they're doing is putting rules and frameworks on it."* Regarding more informal reviews of culture, one member noted that both internal and external audit are the eyes and ears of the audit committee, and another mentioned assistance from the human resources function.

Perspectives on the responsibilities of the external auditor

While European audit chairs saw opportunities to adjust the function of the external auditor in detecting and preventing fraud, most did not endorse large-scale role redefinitions.

The external auditor provides an adequate and appropriately limited role in preventing and detecting fraud

Most European audit chairs were not inclined to increase the auditor's existing role in fraud detection and prevention. Several noted that external auditors already play a role in preventing and detecting fraud within the confines of their assurance responsibilities. *"The auditors do a lot for my companies. They start with key risks. But there is a finite number of accounting standards, and only a subset of those creates risks,"* one audit chair observed. Another said, *"Auditors review the processes management has in place to detect fraud. They always assess internal controls for the management letter. There are many opportunities to find gaps in the system. I'm not sure what advantage more thoroughness would provide."* The auditor is invaluable in providing the audit committee with independent perspectives on transactions and balances, one member added, and others noted that the external auditor can provide valuable perspective to the audit committee on the company's culture.

Others questioned the value of broadening external audit's scope and saw the potential for it to detract from the auditor's other work. *"Expanding the auditor's scope with respect to detecting fraud would increase work and fees without delivering proportional value,"* one audit chair said. Another noted, *"I struggle to imagine what more the auditors could do. Reduce materiality to naught? If the CEO and CFO are colluding, the external auditor would struggle to uncover that as much as anyone."* Another, asserting that fraud prevention and detection is better addressed by internal audit, said, *"Fraud risk should not be viewed differently from other enterprise risks. The external auditor is not the main tool for working with that. If the external auditor looks more into this, it will devalue its work in other important specialties, of which they have many."*

Yet there may be room for external auditors to do more

Despite general agreement against large-scale expansion of external audit's role, some European audit chairs said that external auditors can and should do more to prevent and detect fraud. One said, *"The auditor should do more … Fraud is one of the most detrimental things for companies, and sometimes the external auditor did not see it. We should put a higher level of responsibility on them, and the results should be tested."*

An audit chair observed that the external auditor has a wide range of assurance expertise, such as in cybersecurity, compliance, and internal controls, and said that there is no reason not to leverage that expertise for the purposes of fraud detection and prevention. Another audit chair noted that external auditors currently have tools, such as data analytics and artificial intelligence, which help them detect fraud, but that *"they could do much more."*

Many audit chairs were reluctant to endorse requiring the external auditor to assume liability for fraud detection and prevention. One referred to liability as *"the elephant in the room that affects a lot of stakeholders' responses to these proposals."* Another audit chair was concerned that imposing liability on external auditors could threaten their existence: *"There aren't many big audit firms out there, and we can't lose any of them."*

Data analytics are powerful tools for detecting and preventing fraud, but concerns exist

Several audit chairs said that requiring the use of data analytics to detect and prevent fraud would be a positive step. *"You need more procedures with data analytics. There's no other practical way,"* one said. *"I would mandate the use of data analytics because the technology is available and it's so efficient and comprehensive,"* another said. Most chairs endorsed the use of data analytics and supported its continued adoption. Many reported that such technologies already are in productive use by management among large global companies.

An increased emphasis on fraud and data analytics will call for sharpened skills in both management teams and external auditors. An audit chair pointed to a skills gap between the partners in audit firms and some of the junior auditors, who may have stronger capabilities in advanced technology: *"Sometimes the partners see data analytics as a black art."*

Some audit chairs expressed hesitation about requiring the use of data analytics. One observed that the technology, while powerful, is not fail-safe: *"Data analytics depends on all the systems it touches. Poor systems, such as insufficient controls around data, curtail the ability of data analytics to do its work. Data analytics is only as good as the data."* Another audit chair observed that not all companies have data of sufficient volume or sophistication to enable effective analytics: *"Not all companies are equipped for the auditor to use those tools on their data. We still have a long way to go."*

Conversely, sometimes the auditor's systems are not well aligned with the client's data: *"Auditors have a concept of a tool, but they deploy it with data hierarchies and analytics. The question arises, How big is the sample going to be, and is it enough? It would be great if we all had big data lakes and our taxonomies were sorted out to enable data analytics, but data is one of the biggest weaknesses in the European environment. Will the external auditor have to test all these things too?"*

A suspicious mindset goes too far

While supportive of exploring ways to make auditors adopt a "suspicious mindset" toward their clients. They foresaw several negative consequences:

- **Strained auditor-client relationships that impede the flow of information.** Many audit chairs were concerned that a suspicious mindset would cause friction in the critical relationships between the external auditor and its clients. One audit chair described how a suspicious mindset would disrupt these engagements: *"Companies try to do the right thing. The auditors are there to confirm that they have. A suspicious mindset could be detrimental to the audit by disrupting that clear and open relationship. It goes a step too far."* Audit chairs worried that an attitude of suspicion would impede audits by restricting clients from voluntarily providing information. One audit chair expected that *"information flow would be constrained and everything would be looked at through liability"* if a suspicious mindset were the standard.
- **A heightened burden for the auditor, with limited potential return.** Some audit chairs doubted that a suspicious mindset would create more inquiry or meaningful improvements in fraud detection or prevention. One said, *"The auditor could probably uncover questionable internal audit decisions with a suspicious mindset—but fraud? It seems unlikely, especially in a large global company. Fraud often involves three intelligent individuals colluding, and that's hard to detect."* Another audit chair likened the suspicious mindset to *"cracking a walnut with a sledgehammer"* and noted that *"there should be appropriate challenge, but I believe that's already occurring."*
- **Unfairness to law-abiding companies.** Audit chairs were concerned that requiring a suspicious mindset would unduly burden the many companies at which material fraud is not occurring or not likely to occur. *"There will always be some fraud, but we can't be suspicious of all companies,"* one audit chair said. Another agreed: *"A suspicious mindset implies that everyone is guilty, yet 99% of the time the right thing has been done."*

Audit chairs noted that less divisive alternatives are available. Many were comfortable with the current standard of professional skepticism; others advocated for the basic concept of *"independence"* or *"thorough but not suspicious inquiry."* One audit chair, contrasting a suspicious mindset with healthy skepticism, said a suspicious mindset *"shifts burden of proof. Healthy skepticism carries an assumption of innocence. Changing the assumptions wouldn't necessarily prevent or detect more fraud."* Another audit chair suggested that *"a <u>curious</u> mindset would be better—we need auditors to be independent, ready to ask questions, probing, going from a simple question to questions of the second and third order."*

Auditors and clients would benefit from forensics training, but forensic auditing for fraud is rarely needed

Many audit chairs endorsed requiring forensics training for auditors. One chair observed that additional training could sharpen their auditor's focus on red flags: *"Training might make them more aware of what's happening rather than suspicious about everything."* Another chair agreed, calling forensics *"part of the work of getting the audit done but, due to the power of automation, not much additional work."* One believed that forensics training would be a necessary accompaniment to a suspicious mindset: *"You can't have a suspicious mindset and not know what to do or not have the tools. Giving the external auditor responsibility but not mandating capabilities would be inconsistent."*

Audit chairs were less convinced that forensic specialists should be part of most audit teams. A primary reason is that forensics accounting is retrospective and largely unrelated to preventing future fraud or detecting ongoing fraud. *"Forensic specialists come in after the event has occurred; they can't tell you what is going to go wrong before it does. They are no more capable of detecting fraud than anyone else,"* one audit chair said. Another agreed that the state of assurance practice is not geared to involving forensic specialists on every audit team: *"You only want to use forensic specialists if there's already an indication of an issue—not as part of normal practice."* Another audit chair considered forensics a *"special skill"* that should not be expected of auditors but added that *"if questions are raised, the auditors should have access to those specialists."*

One audit chair had a far more positive view on forensic skills in audit firms, especially in regulatory regimes that are driving separation between assurance and consulting services. *"Forensic accounting is an opportunity for the firms to broaden their skill bases, to embed different ways of working and thinking. They will not only be more relevant to their clients but also more attractive to young talent."*

Additional auditor disclosures would provide limited net benefit

European audit chairs did not see a need or worthy purpose for additional formal disclosures from their auditors. The audit chairs observed that, absent the discovery of a material fraud or other anomaly affecting the accuracy of financial statements, investors rarely take close interest in the work of the audit committee or the external auditor. Additional disclosures, audit chairs said, would likely have minimal impact on investor satisfaction in routine circumstances. One audit chair explained that requiring more disclosures in the normal course could have consequences: *"Investors would expect a particular structured approach to how auditors go about their business and identify controls inadequacies. That's not a good outcome."*

Appendix: Feedback on the IAASB discussion paper *Fraud and Going Concern in an Audit of Financial Statements*

Tapestry Networks submits the following in response to the IAASB's solicitation for feedback on its discussion paper *Fraud and Going Concern in an Audit of Financial Statements.*

Background and context

In late 2020, Tapestry Networks convened audit committee chairs from some of Europe's largest companies to discuss how the various stakeholders can contribute to detecting and preventing corporate fraud in the context of the public company environment in Europe.

The audit chairs whom we interviewed serve on boards of listed European companies having at least US$10 billion/€8.2 billion in annual revenue and global operations. Such companies typically retain Big Four firms to conduct external audits and have sophisticated internal audit teams and robust internal-controls frameworks. Audit chairs of smaller or less complex companies may have different perspectives. The responses we have provided to questions 2(a), 2(b) and 2(c) represent the views of Tapestry Networks; we do not attribute these conclusions to the audit chairs we interviewed, individually or as a group.

The following current and former audit chairs participated in interviews and meetings between November 2020 and January 2021:

- Carolyn Dittmeier, Chair, Board of Statutory Auditors, Assicurazioni Generali
- Eric Elzvik, Audit Committee Chair, Ericsson
- Byron Grote, Audit Committee Chair, Tesco, Akzo Nobel, and Anglo American
- Simon Henry, Audit Committee Chair, Rio Tinto
- Liz Hewitt, Audit Committee Chair, National Grid and Melrose
- Lou Hughes, former Audit Committee Chair, ABB
- Arne Karlsson, Audit Committee Chair, Mærsk
- John Rishton, Audit Committee Chair, Unilever
- Sarah Russell, Audit Committee Chair, Nordea Bank
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The interviews and discussions were held under a modified form of the Chatham House Rule, which allows for quotation of any comment but not for its attribution to an individual or company. Audit chairs spoke on their own behalf, rather than as representatives of their companies or boards. EY provided financial support for the research and writing of this report and had opportunities to comment on the research design and the final product but did not exercise any editorial control over this report, for which Tapestry Networks bears full responsibility.

Answers to selected IAASB questions for respondents

The following, excerpted from our interviews with the above-mentioned European audit chairs, represent responses to selected "questions for respondents" on pages 6–7 of the IAASB's discussion paper.

2(a). Should the auditor have enhanced or more requirements with regard to fraud in an audit of financial statements?

Response: No. While the audit chairs we interviewed saw opportunities to adjust the function of the external auditor in detecting and preventing fraud, most did not endorse large-scale role redefinition, and they were not inclined to increase the auditor's burden or expand its role in fraud detection and prevention through enhanced requirements.

Several audit chairs noted that external auditors already play an adequate and appropriately limited role in preventing and detecting fraud within the confines of their assurance responsibilities. *"The auditors do a lot for my companies. They start with key risks. But there is a finite number of accounting standards, and only a subset of those creates risks."* one audit chair observed. Another said, *"Auditors review the processes management has in place to detect fraud. They always assess internal controls for the management letter. There are many opportunities to find gaps in the system. I'm not sure what advantage more thoroughness would provide."* The auditor is invaluable in providing the audit committee with independent perspectives on transactions and balances, one member added, and others noted that the external auditor can provide valuable perspective to the audit committee on the company's culture.

Others questioned the value of broadening external audit's scope and saw the potential for it to detract from the auditor's other work. *"Expanding the auditor's scope with respect to detecting and preventing fraud would increase work and fees without delivering proportional value,"* one audit chair said. Another noted, *"I struggle to imagine what more the auditors could do. Reduce materiality to naught? If the CEO and CFO are colluding, the external auditor would struggle to uncover that as much as anyone."* Another, asserting that fraud detection is better addressed by internal audit, said, *"Fraud risk should not be viewed differently from other enterprise risks. The external auditor is not the main tool for working with that. If the external auditor looks more into this, it will devalue its work in other important specialties, of which they have many."*

Nonetheless, some European audit chairs noted that external auditors could do more to prevent and detect fraud. *"The auditor should do more … Fraud is one of the most detrimental things for companies, and sometimes the external auditor did not see it. We should put a higher level of responsibility on them, and the results should be tested,"* one audit chair said.

An audit chair observed that the external auditor has a wide range of assurance expertise, such as in cybersecurity, compliance, and internal controls, and said that there is no reason not to leverage that expertise for the purpose of fraud detection. Another audit chair noted that external auditors currently have tools, such data analytics and artificial intelligence, which help them detect fraud, but that *"they could do much more."*

Many audit chairs were reluctant to endorse requiring the external auditor to assume liability for fraud detection and prevention. One referred to liability as *"the elephant in the room that affects a lot of stakeholders' responses to these proposals."* Another audit chair was concerned that imposing liability on external auditors could threaten their existence: *"There aren't many big audit firms out there, and we can't lose any of them."*

2(b). Is there a need for enhanced procedures only for certain entities or in specific circumstances?

Response: No. Audit chairs did not express a view that listed companies or companies of a certain size or in a certain sector should require a higher standard of auditing for fraud. It is Tapestry's view that there should not be variations in standards based on these differentiators. However, as indicated above, the audit chairs we interviewed sit on the boards of large listed companies, which typically retain Big Four audit firms and have robust internal audit departments. Their responses may be less applicable to the question of enhanced procedures for smaller entities.

2(c). Would requiring a "suspicious mindset" contribute to enhanced fraud identification when planning and performing the audit? Why or why not?

Response: No. While supportive of exploring ways to make auditors more effectively exercise professional skepticism, the European audit chairs explained that adopting a suspicious mindset in all cases may not be helpful. They foresaw several negative consequences:

- **Strained auditor-client relationships that impede the flow of information.** Many audit chairs were concerned that a suspicious mindset would cause friction in the critical relationships between the external auditor and its clients. One audit chair described how a suspicious mindset would disrupt these engagements: *"Companies try to do the right thing. The auditors are there to confirm that they have. A suspicious mindset could be detrimental to the audit by disrupting that clear and open relationship. It goes a step too far."* Audit chairs worried that an attitude of suspicion would impede audits by restricting clients from voluntarily providing information. One audit chair expected that *"information flow would be constrained and everything would be looked at through liability"* if a suspicious mindset were the standard.
- **A heightened burden for the auditor, with limited potential return.** Some audit chairs doubted that a suspicious mindset would create more inquiry or meaningful improvements in fraud detection or prevention. One said, *"The auditor could probably uncover questionable internal audit decisions with a suspicious mindset—but fraud? It seems unlikely, especially in a large global company. Fraud often involves three intelligent individuals colluding, and that's hard to detect."* Another audit chair likened the suspicious

mindset to *"cracking a walnut with a sledgehammer"* and noted that *"there should be appropriate challenge, but I believe that's already occurring."*

- **Unfairness to law-abiding companies.** Audit chairs were concerned that requiring a suspicious mindset would unduly burden the many companies at which material fraud is not occurring or not likely to occur. *"There will always be some fraud, but we can't be suspicious of all companies,"* one audit chair said. Another agreed: *"A suspicious mindset implies that everyone is guilty, yet 99% of the time the right thing has been done."*

Audit chairs noted that less divisive alternatives are available. Many were comfortable with the current standard of professional skepticism; others advocated for the basic concept of *"independence"* or *"thorough but not suspicious inquiry."* One audit chair, contrasting a suspicious mindset with healthy skepticism, said a suspicious mindset *"shifts burden of proof. Healthy skepticism carries an assumption of innocence. Changing the assumptions wouldn't necessarily prevent or detect more fraud."* Another audit chair suggested that *"a curious mindset would be better—we need auditors to be independent, ready to ask questions, probing, going from a simple question to questions of the second and third order."*